

Message Text

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ACTION NEA-10

INFO OCT-01 EUR-12 ISO-00 SAB-01 IO-10 CIAE-00 DODE-00

PM-03 H-01 INR-05 L-02 NSAE-00 NSC-05 PA-01 RSC-01

PRS-01 SP-02 SS-15 USIA-06 AID-05 COME-00 EB-04

FRB-01 TRSE-00 XMB-02 OPIC-03 CIEP-01 LAB-01 SIL-01

OMB-01 STR-01 CEA-01 ABF-01 FS-01 /099 W

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R 141337Z NOV 74

FM AMEMBASSY BEIRUT

TO SECSTATE WASHDC 1324

INFO AMEMBASSY AMMAN

AMEMBASSY CAIRO

AMEMBASSY DAMASCUS

AMEMBASSY KUWAIT

AMEMBASSY LONDON

AMEMBASSY PARIS

USINT BAGHDAD

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E.O. 11652: N/A

TAGS: EFIN, LE

SUBJECT: CENTRAL BANK DEVALUING POUND?

REF: BEIRUT 11363 (NOTAL)

SUMMARY: LEBANON'S CENTRAL BANK ENGAGED IN DOLLAR-BUYING
OPERATION WHICH IN LITTLE MORE THAN TWO WEEKS HAS "DEVALUED"
LEBANESE POUND IN BEIRUT FREE MARKET BY ALMOST 10 PER CENT BUT,
IN SAME SHORT PERIOD, HAS INCREASED MONEY SUPPLY AT LEAST 13 PER
CENT. BANKERS EXPECT DOUBLING OF RESERVE REQUIREMENT SHORTLY
TO NEUTRALIZE INFLATIONARY IMPACT AND EVEN SOME SORT OF
CONTROLS ON CAPITAL INFLOW IF OPERATION INTENDED HAVE PERMANENT
EFFECTS BUT THIS QUESTIONABLE, AS ARE MOST REASONS GOL SPOKESMEN
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GIVE FOR OPERATION.

1. SINCE 1971 DOLLAR DEVALUATION, LEBANESE POUND (LL) HAS APPRECIATED BY ABOUT 32 PER CENT AGAINST DOLLAR, FROM LL3.23 PER DOLLAR TO RECENT RATE OF ABOUT LL 2.20, ITS APPARENT FLOOR DURING PAST 18 MONTHS. DURING 1974 DOLLAR RATE DROPPED FROM ABOUT LL 2.50 IN JANUARY TO LL 2.20 DURING OCTOBER. POUND'S STRENGTH ATTRIBUTED TO CAPITAL INFLOW FROM OVERSEAS LEBANESE AND OIL-PRODUCING COUNTRIES, INFLOW WHICH WITH LARGE SURPLUS ON SERVICES (MOSTLY DUE TOURISM) MORE THAN OFFSETS LARGE TRADE DEFICIT, PRODUCING BALANCE OF PAYMENTS SURPLUSES EACH YEAR SINCE AT LEAST 1960 EXCEPT FOR SMALL DEFICIT 1967. FEARS OVER ADVERSE EFFECTS ON EXPORTS OF POUND'S APPRECIATION HAVE NOT BEEN REALIZED, ACCORDING OUR INDICATORS, WHICH THROUGH THIRD QUARTER SHOW TOURISM AT NEW RECORD AND INDUSTRIAL EXPORTS AT TWICE LEVEL SAME PERIOD LAST YEAR. LEBANON'S CENTRAL BANK, BANQUE DU LIBAN (BANQUE), ACCORDINGLY HAS MAINTAINED RELATIVELY PASSIVE STANCE TOWARD EXCHANGE RATE, INTERVENING OCCASIONALLY AND BRIEFLY TO MODERATE SHARP CHANGES OR TO BUMP RATE UP A FEW PERCENTAGE POINTS FOR BRIEF PERIODS. TRADITIONAL FREEDOM OF INTERNATIONAL CAPITAL MOVEMENTS HAS BEEN MAINTAINED AND WITH IT BELIEF THAT EXCHANGE RATE CANNOT BE MANAGED, AT LEAST IN EVENT OVERWHELMING CAPITAL INFLOW.

2. THIS BELIEF NOW THREATENED BY RECENT BANQUE ACTIVITY WHICH, ALTHOUGH SO FAR NOT ACKNOWLEDGED AS SUCH, APPEARS TO BE ATTEMPT "DEVALUE" POUND BY MANAGING RATE. STRONG AND ACKNOWLEDGED DOLLAR PURCHASES BY BANQUE ON BEIRUT FOREIGN EXCHANGE (FOREX) MARKET HAVE "DEVALUED" POUND AGAINST DOLLAR BY ALMOST 10 PERCENT SINCE OCTOBER 26, FROM ABOUT LL 2.20 TO LL 2.40, WHICH MAY BE INTENDED AS NEW FLOOR ALTHOUGH SOME THINK EVENTUAL TARGET IS LAST JANUARY'S RATE OF LL 2.50. HEAVY INITIAL BUYING HAS TAPERED OFF THIS WEEK TO SPORADIC INTERVENTION IN AMOUNTS RUMORED AT ABOUT \$5 MILLION DAILY, ABOUT TWICE NORMAL DAILY FOREX TURNOVER. ESTIMATES, UNCONFIRMED, OF TOTAL DOLLARS ABSORBED RANGE UP TO \$400 MILLION (WE RECKON IT CLOSER \$300 MILLION), LARGE SUM FOR BANQUE.

3. WHEN IT BECAME OBVIOUS THIS NO ROUTINE OPERATION, PRESS LIMITED OFFICIAL USE

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AND OPPOSITION POLITICIANS BEGAN ASKING WHO MAKING KILLING, WHY SUCH ABOUT-FACE FROM PROLONGED PASSIVE STANCE WHEN DOLLAR FALLING ELSEWHERE. RUMOR MILL SOON PRODUCED PLOT THEORY: BANQUE BAILING OUT A FEW INDUSTRIAL FIRMS ON VERGE BANKRUPTCY OR BANKS FACING LARGE FOREX LOSSES. BANQUE OF COURSE HAS OFFERED NO EXPLANATION BUT HAS BEEN QUOTED BY COLUMNISTS AS AIMING TO IMPROVE INTERNATIONAL COMPETITIVE POSITION TOURIST AND MANUFACTURING INDUSTRIES, RATHER

UNCONVINCING GROUNDS VIEW THEIR RECORD-BREAKING PERFORMANCE THIS YEAR (IF OUR INDICATORS CORRECT). SUPPORTING BANQUE, NEW (IN OFFICE TWO WEEKS) GOL FINMIN AND ECONMIN ADDED THAT CURRENT ACCOUNT IN HEAVY DEFICIT (NOTHING NEW BUT AVAILABLE INDICATORS DO NOT PERMIT ASSESSMENT THIS CLAIM), DOMESTIC COST LEVELS RISING, WEIGHTED APPRECIATION POUND AGAINST ALL CURRENCIES SINCE START 1973 AND REACHED 22 PER CENT.

4. OTHER POSSIBLE FACTORS BEHIND OPERATION MAY OR MAY NOT BE (1) ADVENT OF NEW GOVERNMENT FEW DAYS AFTER OPERATION STARTED, (2) CONCLUSION OF ANNUAL IMF RPT IMF CONSULTATIONS FEW DAYS BEFORE OPERATION STARTED, (3) EURODOLLAR OR OTHER OVERSEAS DEVELOPMENTS SUCH AS INTERNATIONAL SUPPORT OPERATION FOR DOLLAR, (4) SOME INTER-ARAB DEAL PROMISING FUTURE BENEFITS FOR LEBANON.

5. WHATEVER CASE, BANQUE MURMURINGS AND GOL STATEMENTS IMPLY THAT OPERATION IS LONG-TERM RATE MANAGEMENT EFFORT. THIS RAISES PROBABILITY OF NEW CONTROLS ON MONEY SUPPLY THROUGH BANKS AND POSSIBILITY OF BREAKING TRADITION OF FREE INTERNATIONAL CURRENCY MOVEMENTS TO KEEP FROM BEING OVERWHELMED BY DOLLARS ONCE WORD GETS AROUND, UNLESS DOLLAR IMPROVES ELSEWHERE. DURING 1974 TO MID-OCTOBER, MONEY SUPPLY (M1) GAINED 19 PER CENT, TO LL 2.739 BILLION. DURING LAST TWO WEEKS OCTOBER ALONE, HOWEVER, BANQUE'S OPERATION INCREASED SUPPLY BY LL 351 MILLION OR 13 PER CENT, WITH LIKE INCREASE FORECAST FOR FIRST-HALF NOVEMBER REPORTING PERIOD. SUCH INCREASES PORTEND NEW BOUT INFLATION (AT TIME WHEN INFLATION RATE MAY HAVE STABILIZED AT 12-15 PER CENT) UNLESS NEUTRALIZED. BANKS THUS EXPECT INCREASE IN COMMERCIAL BANKS' RESERVE REQUIREMENT, NOW SEVEN PER CENT, TO 15 PER CENT OR LIMITED OFFICIAL USE

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EVEN LEGAL LIMIT OF 25 PER CENT TO MOP UP NEW POUNDS. NOT CLEAR WHETHER THIS WOULD SUFFICE BUT CLEAR THAT INTEREST RATES WOULD RISE. UNLESS BANQUE PREPARED BUY REGION'S PETRODOLLARS, OR CURRENT INTERNATIONAL MONETARY ENVIRONMENT CHANGES, PERMANENT RATE MANAGEMENT PROBABLY MUST EVENTUALLY BE ACCOMPANIED BY CAPITAL CONTROLS, SUCH AS NEGATIVE INTEREST RATES, WHICH COULD RETARD REALIZATION BEIRUT'S INTERNATIONAL BANKING ASPIRATIONS.

6. REMAINS BE SEEN HOW PERMANENT OPERATION IS. ONE BANKER THINKS IT MAY CONTINUE THROUGH YEAR END, PERMITTING BANKS ISSUE IMPRESSIVE PROFIT/LOSS STATEMENTS AND BALANCE SHEETS. MEANWHILE, EMBASSY MORALE GREATLY IMPROVED.

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: CENTRAL BANK, ANTIINFLATIONARY PROGRAMS, DEVALUATIONS
Control Number: n/a
Copy: SINGLE
Draft Date: 14 NOV 1974
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: cunninfx
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1974BEIRUT13652
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Film Number: D740328-1059
From: BEIRUT
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1974/newtext/t19741145/aaaablpx.tel
Line Count: 170
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION NEA
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 4
Previous Channel Indicators:
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: BEIRUT 11363 (NOTAL)
Review Action: RELEASED, APPROVED
Review Authority: cunninfx
Review Comment: n/a
Review Content Flags:
Review Date: 02 MAY 2002
Review Event:
Review Exemptions: n/a
Review History: RELEASED <02 MAY 2002 by rowelle0>; APPROVED <18 MAR 2003 by cunninfx>
Review Markings:

Declassified/Released
US Department of State
EO Systematic Review
30 JUN 2005

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: CENTRAL BANK DEVALUING POUND?
TAGS: EFIN, LE
To: STATE
Type: TE
Markings: Declassified/Released US Department of State EO Systematic Review 30 JUN 2005